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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HARRIS TRUST AND SAVINGS BANK, As Trustee of the Sperry Master Retirement Trust No. 2,

Cross-Petitioner,

vs.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Cross-Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

CROSS-PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether under the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1002(21)(A), an insurer is a fiduciary with respect to a group annuity contract over which the insurer has exercised contractual power in its sole and unfettered discretion and the exercise of such power affects the value of the contract to the plan.

Whether an insurer is an ERISA fiduciary (i) where the insurer manages a fund which commingles funds supporting guaranteed benefits with funds used for pension benefits which are not guaranteed by the insurer and (ii) where the investment income generated by the funds supporting guaranteed benefits is available for the purpose of providing pension benefits which are not guaranteed by any insurer.

PARTIES

The parties to the action below were Cross-petitioner Harris Trust and Savings Bank ("Harris Trust"); Cross-respondent John Hancock Mutual Life Insurance Company ("Hancock"); counterclaim defendant Chase Manhattan Bank, N.A. ("Chase"), which was succeeded as trustee of the Sperry Master Retirement Trust No. 2 on October 1, 1987, by Harris Trust; and third-party defendants Sperry Corporation ("Sperry") and The Retirement Committee of Sperry Corporation ("SRC").

The party to this brief, Harris Trust and Savings Bank, is acting as party to this appeal only in its capacity as Trustee of the Sperry Master Retirement Trust No. 2 (and of its successor, the Unisys Master Trust) (collectively the "Plan") and is not otherwise affected by the outcome of this litigation. The Bank of Montreal is a parent of Harris Trust and Savings Bank.

Hancock is a mutual insurance company; it does not have any parent companies or subsidiaries to list pursuant to Rule 29.1.

Cross-petitioner is not aware of any other parent companies or subsidiaries to list pursuant to Rule 29.1.

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CROSS-PETITION FOR A WRIT OF CERTIORARI

Cross-petitioner Harris Trust respectfully cross-petitions for a writ of certiorari to review so much of the judgment of the United States Court of Appeals for the Second Circuit as determined that Cross-respondent Hancock is not a fiduciary pursuant to the fiduciary responsibility provisions of ERISA, with respect to (i) a certain group annuity contract issued to Harris Trust known as "GAC 50" or the "Contract" and (ii) all of the funds held by Hancock that are associated with GAC 50.

OPINIONS BELOW

The opinion of the court of appeals is reported at 970 F.2d 1138. A-1.[1] The two opinions of the district court are reported at 722 F. Supp. 998 ("Harris I") (A-21), and 767 F. Supp. 1269 ("Harris II") (A-63); the judgment of the district court was entered on August 16, 1991 (A-89).

JURISDICTION

The judgment of the court of appeals was entered on July 30, 1992 (A-19). The court of appeals denied Hancock's petition for rehearing and suggestion for rehearing *in banc* on September 23, 1992 (A-91). This Cross-petition for a Writ of Certiorari is filed pursuant to Supreme Court Rule 12.3 in connection with Hancock's Petition for a Writ of Certiorari, filed December 22, 1992, and served upon Harris Trust on December 22, 1992 ("Hancock Petition" or "HP"). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1). This petition is filed within the time allowed by law.

STATUTES AND REGULATIONS INVOLVED

The following statutory provisions are invovled in the case and are fully set forth in the Hancock Petition in the Appendix beginning at A-93: 29 U.S.C. § 1002 (21)(A) and 1101 (b)(2).

STATEMENT OF THE CASE

Harris Trust seeks review of a decision of the Court of Appeals for the Second Circuit that Hancock is not a fiduciary under the fiduciary responsibility provisions of ERISA with respect to (i) a group annuity contract over which Hancock has exercised contractual power in its sole and unfettered discretion and (ii) all of the funds held and invested by Hancock under GAC 50.

With respect to the first issue, the Second Circuit decision directly conflicts with a series of decisions of the Seventh

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[1] "A-____" refers to the pages of the Appendix annexed to Hancock's Petition for a Writ of Certiorari, Docket No. 92-1074, filed with the Court on December 22, 1992.

Circuit, each of which holds that an insurer's exercise of discretionary control over a group annuity contract subjects the insurer to ERISA's fiduciary obligations where the exercise of that discretion alters the pension plan's rights under the contract or the value of the contract to the plan. By refusing to find that Hancock is a fiduciary with respect to the contract, the Second Circuit's has left the Plan at the mercy of Hancock's Unilateral exercise of discretion with respect to fundamental issues concerning the handling of pension investment funds. In effect, the decision below allows Hancock to exercise its unfettered discretion in allocating income and expenses to GAC50, and in controlling the way in which free funds held by Hancock are used by the Plan. The Second Circuit's construction renders contractholders like the Plan hostage to potential self-dealing and other breaches of fiduciary duty, with all of the risk borne by the contractholder and, hence, the pension beneficiaries.

On the second issue, without addressing it directly, the Second Circuit implicitly held that, although the funds not supporting guaranteed benefits were plan assets subjecting Hancock to ERISA fiduciary responsibility, the balance of the funds held by Hancock were not plan assets. This result conflicts with a decision of the Seventh Circuit and with a District Court decision in the Second Circuit. Furthermore, the decision exempts from ERISA potentially hundreds of billions of dollars, that are invested in insurance company general accounts for the purpose of providing pension benefits which, as discussed below, are not guaranteed by any insurer. As such, the decision conflicts with the central tenets of ERISA.

Factual Background

Hancock and Sperry Rand Corporation[2] entered into GAC 50 in 1941. A discussion of GAC 50's terms and amendments is contained in the Second Circuit's decision (A-4-6), which is

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[2] Sperry Rand Corporation was succeeded by Sperry Corporation (collectively "Sperry") and later the Trustee as the contractholder of GAC 50.

hereby incorporated. A few factual issues however, were stated either incorrectly or not mentioned at all in the decision. Those matters are discussed below.

Pursuant to the 1968 Amendment ("68 Amendment"), Hancock placed the assets supporting annuities purchased prior to 1968, which were cancelled pursuant to the 68 Amendment, in a Pension Administration Fund ("PAF" or "PA Fund") and a Contingency Account assigned to GAC 50.[3] Hancock annually allocated net investment income to GAC 50's PA Fund on the funds in the PA Fund *and* Contingency Account. J.A. 530, 545.[4] The Second Circuit's statement that "Hancock in effect guaranteed that the PAF would never fall below its January 1, 1968 level" is incorrect. A-5. Hancock never provided any guarantee of a minimum investment return under GAC 50 nor a real guarantee of principal. Hancock in fact only "guaranteed" that the PA Fund would never be less than its starting balance, plus any contributions by the Plan, minus all expenses and benefit payments made from the PA Fund. J.A. 655-57. Thus, the "principal" that was guaranteed dropped progressively as benefits were paid, although the size of the PA Fund was increasing due to investment income credited to the PA Fund. J.A. 529-30.

Although not stated by the Second Circuit, the LOF[5] for the benefit obligations attributable to GAC 50 was and still is computed using extraordinarily low investment return assumptions

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[3] The 1968 starting balance of the PA Fund was $108 million; thereafter, only nominal contributions were ever made to that fund. J.A. 529, 531, 655-656.

[4] "J.A. ____" refers to the pages of the parties Joint Appendix submitted in connection with the appeal to the Second Circuit.

[5] LOF (the "Liabilities of the Fund") is a contractual reserve for the Plan's possible future purchase of annuities in the event the contract is ever terminated. The LOF assumptions of interest, mortality and expenses become the purchase rates for such annuities in the event of termination.

of 2.5 and 3 percent.[6] J.A. 525, 531-532. Hancock refers to the amount in the PA Fund in excess of 105% of LOF as "free funds" or "free money." J.A. 250-56, 1102. Under a subsequent amendment (the "77 Amendment"), the Plan had the exclusive right on a prospective basis to select Plan participants to receive "non-guaranteed benefits" from the free funds in the PA Fund. J.A. 543-44.

Because the LOF was set at a far higher level than necessary and because the PA fund was earning at far higher actual rates than the present value interest assumptions used for computing the LOF, the level of free funds in the PA Fund continued to increase throughout the 1970's. In that same period Hancock instituted a "rollover" procedure whereby, under certain circumstances, Hancock would permit the annual withdrawal of positive cash flow from a contractholder's PA Fund. Hancock allowed two withdrawals under the rollover procedure — in 1979 and 1981. Hancock subsequently eliminated the procedure in 1982. J.A. 444-47, 542-43, 1107, 1382-86.

In order to utilize the "free funds" in GAC 50 without triggering the purchase of what it believed to be greatly over-priced annuities, the SRC amended the Plan in early 1982 to add additional Plan participants to the group eligible to receive non-guaranteed benefits under GAC 50 and requested payment of non-guaranteed benefits to these additional beneficiaries from the PA Fund's free funds. After paying two months of the additional benefits, Hancock unilaterally terminated all future payments of non-guaranteed benefits under the 77 Amendment. J.A. 544, 1114-16. As a result of Hancock's elimination of the rollover procedure and its termination of non-guaranteed benefit payments, the Plan had no means of withdrawing any of the Contract's continually increasing free funds without terminating the Contract and causing the purchase of annuities at grossly

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[6] LOF interest assumptions are used to calculate as of a specific point in time the present value of the probable stream of benefits to be paid in the future to retirees. The interest assumptions should predict the rate at which money grows. The lower the interest assumptions, the higher the present value of future benefits and, thus, the amount which must be maintained in the PA Fund to support future benefit payments.

inflated prices. Thus, Hancock had exclusive control of the Plan's access to free funds held under GAC 50 and in so doing determined the value of GAC 50 to the Plan and the availability to the Plan of funds to pay benefits.

The Second Circuit Decision

Although the Second Circuit held that GAC 50 is a "plan asset," the court failed to hold that Hancock was a fiduciary with respect to its discretionary power under the Contract itself. In considering Hancock's obligations with respect to the Contract, the Second Circuit altered the statutory standard, requiring "power unilaterally to alter or amend" the policy rather than simply "discretionary authority or discretionary control . . . respecting management or disposition of" the policy, as set forth by ERISA (A-14). The Second Circuit acknowledged the decisions of the Seventh Circuit in *Ed Miniat, Inc. v. Globe Life Insurance Group, Inc.*, 805 F.2d 732 (1986), *cert. denied*, 482 U.S. 915 (1987) and *Chicago Board Options Exchange, Inc. v. Connecticut General Life Insurance Co.*, 713 F.2d 254 (1983) ("*CBOE*"), but departed from that court's proper application of ERISA's fiduciary provisions. Finding that Hancock did not have unilateral power to alter or amend the policy, the Second Circuit held that, therefore Hancock is not an ERISA fiduciary with respect to the contract itself.

Nevertheless, in reversing the district court, the Second Circuit held that Hancock is subject to ERISA's fiduciary obligations with respect to "the administration or management of plan assets not referable to guaranteed benefits." A-14. As such, since "free funds" are not immediately required to guarantee benefit payments to Plan participants and because they are subject to fluctuation based upon Hancock's investment performance, the Second Circuit reasoned that Hancock has ERISA fiduciary duties with respect to the administration and management of such funds. A-10-11. The court, however, declined to hold that all of the assets held by Hancock under GAC 50 are plan assets. A-8.

Jurisdiction in the court of first instance was based on Federal questions with respect to ERISA claims, 28 U.S.C. § 1331 and 29 U.S.C. § 1132, and diveristy with respect to common law claims, 28 U.S.C. § 1332(a)(1).

REASONS FOR GRANTING THE WRIT

I.

THE SECOND CIRCUIT'S INTERPRETATION OF THE SCOPE OF ERISA'S FIDUCIARY PROVISIONS WITH RESPECT TO THE CONTRACT CLEARLY CONFLICTS WITH THE SEVENTH CIRCUIT

The Second Circuit decision in this case directly contradicts the Seventh Circuit's decisions in *Ed Miniat*, *CBOE* and their progeny. In each of its decisions, the Seventh Circuit has clearly held that, under ERISA § 1002(21)(A), to the extent that an insurance company exercises discretionary authority or control over a group annuity contract, the insurance company is subject to the fiduciary provisions of ERISA. The Court below, however, refused to apply the fiduciary duty provisions of ERISA unless the insurance company had the "power unilaterally to alter or amend" the plan asset in its entirety. A-14. As a result, the court has opened an enormous gap in the protections afforded by ERISA's fiduciary rules.

The Second Circuit invoked the appropriate ERISA provision setting forth when fiduciary obligations are triggered, only to misconstrue it. ERISA defines a fiduciary as follows:

> a person is a fiduciary with respect to a plan *to the extent* . . . he exercises any discretionary authority or discretionary control respecting management of such plan or *exercises any authority or control respecting management or disposition of its assets*. . . .

29 U.S.C. § 1002(21)(A) (emphasis added). A-93. While the Second Circuit correctly characterized GAC 50 as a "plan asset,"[7] it misapplied ERISA § 1002(21)(A) to GAC 50.

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[7] ERISA § 1101(b)(2) provides that "[i]n the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy . . ." A-94.

GAC 50 clearly conferred upon Hancock broad and unfettered discretion to alter Harris Trust's rights under the contract including power (i) to permit or deny the withdrawal of excess funds through the "rollover" arrangement, (ii) to terminate the payment of non-guaranteed benefits and (iii) to make investment income and expense allocation decisions. *Harris II*, 767 F. Supp. at 1275-76, 1278, 1281-83. In fact, the Second Circuit affirmed the district court's decision that Hancock had unfettered discretion to terminate the payment of non-guaranteed benefits, in effect cancelling the 77 Amendment. At a minimum, then, Hancock undeniably had discretionary authority and control over GAC 50. Under the Seventh Circuit's clear interpretation of ERISA § 1002(21)(A), therefore, Hancock is without question a fiduciary *to the extent* it has exercised such discretionary authority or control.

The Second Circuit failed to apply the express terms of ERISA § 1002(21)(A). Instead, the Second Circuit decision attempted to distinguish *Ed Miniat* and *CBOE*, while losing sight of the ERISA fiduciary provisions. In both *Ed Miniat* and *CBOE*, the insurer manifested its discretionary authority and control over the contract at issue by unilaterally amending it: in *Ed Miniat*, the insurer reduced the annuity Contract's rate of return and increased the annual premium rates; in *CBOE*, the insurer locked the contractholder into certain "guaranteed" accounts for ten years. The proposition for which *Ed Miniat* and *CBOE* stand, however, is not that ERISA's fiduciary obligations will be triggered *only* where an insurance company has exercised its unilateral authority to *amend* the contract, as the Second Circuit suggests. To the contrary the exercise of the authority to amend or alter the contract simply is an example of the type of power that triggers ERISA's fiduciary provisions. *CBOE* and *Ed Miniat*, however, cannot be read as limiting the reach of § 1002(21)(A) to the specific instances at issue in those cases.

While the nature of the discretionary authority and control exercised by Hancock is different from that exercised by the insurers in *Ed Miniat* and *CBOE*, Hancock nonetheless exercised unfettered power over GAC 50, giving rise to precisely those

consequences which ERISA protects against and which the Seventh Circuit has repeatedly sanctioned. The failure to impose a fiduciary duty upon Hancock in essence has left the *value* of GAC 50, a plan asset, entirely at the mercy of Hancock.

Indeed, Hancock's ability to exercise complete discretion regarding whether to permit or deny withdrawals of excess non-guaranteed funds from its general account – in effect to fundamentally alter the value of GAC 50 – "is not qualitatively different from the ability to choose investments." *CBOE*, 713 F.2d at 260. To further paraphrase the Seventh Circuit, Hancock, by "locking [GAC 50's excess funds] into the [General Account,] . . . has effectively determined what type of investment the Plan must make. In exercising this control over an asset of the plan, [Hancock] must act in accordance with its fiduciary obligations." *CBOE*, 713 F.2d at 260.

In substituting its own construction of ERISA, the Second Circuit also held that ERISA's fiduciary obligations are not invoked in a case where the insurer "can act only under the terms of the policy. . . ." A-14. That an insurer acts under the terms of a contract, as the Seventh Circuit correctly instructs, in no way limits the reach of ERISA's fiduciary provisions. While adherence by an insurer to a specific term in a contract, bargained for at arm's length, is not a breach of fiduciary duty, the exercise of *discretionary authority* under a contract may create fiduciary obligations. Explaining its decision in *Schulist v. Blue Cross*, 717 F.2d 1127 (7th Cir. 1983), the Seventh Circuit in *Ed Miniat* stated:

> The defendants in effect argue that no action by an insurer can subject it to fiduciary liability so long as discretion to take the action was granted to it by contract and the contract was entered into at arm's length. This reading of *Schulist* is incorrect. Rather. *Schulist* stands for the proposition that if a specific term (not a grant of power to change terms) is bargained for at arm's length, adherence to that term is not a breach of fiduciary duty. No discretion is

> exercised when an insurer merely adheres to a specific contract term. *When a contract, however, grants an insurer discretionary authority, even though the contract itself is the product of an arm's length bargain, the insurer may be a fiduciary.*

805 F.2d at 737 (emphasis added); *see also F.H. Krear & Co. v. Nineteen Named Trustees*, 810 F.2d 1250, 1259 (2d Cir. 1987) (citing *Schulist* with approval). Hancock has, in almost identical fashion to the insurers in *CBOE* and *Ed Miniat*, acted pursuant to its "rights under the contract." The Second Circuit's suggestion that ERISA's fiduciary provisions are not applicable because Hancock's power "was referable to the terms of [the] policy" represents, at best, a tortured reading of the statute. A-14.

Furthermore, the Second Circuit's conclusion that only the contractholder may be held to fiduciary standards unless the insurer has the power to unilaterally amend the contract runs counter to both the language of ERISA and countless cases concerning the statute's definition of a fiduciary. The Second Circuit's conclusion rests upon a single passage in the legislative history which on its face indicates that, although a trust need not be established to hold plan assets consisting of an insurance contract or policy, the person "who holds the contract is to be a fiduciary. . . ." A-14. This passage does not support the Second Circuit's conclusion that the only fiduciary is the contractholder. Indeed, the statute itself and case law interpreting ERISA are to the contrary.

ERISA clearly envisioned circumstances in which there would be multiple fiduciaries. Section 1002(21)(A), for example, provides that "a person is a fiduciary with respect to the plan to the extent (i) he exercises *any* discretionary authority or discretionary control respecting management of such plan or exercises *any* authority or control respecting management or disposition of its assets. . . ." (emphasis added). A-93. Similarly, Section 1105 sets forth the circumstances under which a fiduciary may be held liable for the misconduct of a co-fiduciary. Although ignored by the Second Circuit, this statutory scheme contradicts the conclusion that *only* the contractholder may be deemed a

fiduciary with respect to a group annuity contract. Furthermore, the Second Circuit ignored the remedial nature of ERISA and the requirement that, as such, its remedial provisions are to be broadly construed. *E.g.*, *Bouton v. Thompson*, 764 F. Supp. 20, 22 (D. Conn. 1991).[8]

Moreover, in concluding that *only* the contractholder may be deemed a fiduciary with respect to the contract itself, the Second Circuit ignored *CBOE*, *Ed Miniat* and their progeny, where the Seventh Circuit held that an insurance company in certain circumstances is a fiduciary with respect to the administration of a group annuity contract. Thus, even if *CBOE* and *Ed Miniat* were distinguishable on their facts from this case, the mere fact that the insurers *and* the contractholders were found to be fiduciaries as to the group annuity contracts at issue in those cases contradicts the Second Circuit's holding.

Finally, Hancock's decision to retain free funds by terminating the "rollover" arrangement and the payment of non-guaranteed benefits substantially increased its compensation, by raising its risk charge and expense recoveries and improving its cash flow. As the Second Circuit itself previously held in *F.H. Krear*, a party's ability to protect its cash flow and to enhance its fees and charges is effectively a determination of the amount of its compensation and, in this case, most certainly rendered Hancock a fiduciary:

> On the other hand, *after* a person has entered into an agreement with an ERISA-covered plan, the *agreement may give it such control* over factors that determine the actual amount of its compensation that the person thereby *becomes an ERISA fiduciary* with respect to that compensation.

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[8] *Accord Blatt v. Marshall & Lassman*, 812 F.2d 810, 812 (2d Cir. 1987) ("Congress intended the term [fiduciary] to be broadly construed. '[T]he definition includes persons who have authority and responsibility with respect to the matter in question, regardless of their formal title.' ") (*quoting* H.R. Rep. No. 1280, 93d Cong. 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Admin. News 4639, 5038, 5103); *F.H. Krear*, 810 F.2d at 1259.

810 F.2d at 1259 (emphasis added) (citing *Sixty-Five Security Plan v. Blue Cross & Blue Shield*, 583 F. Supp. 380, 387-88 (S.D.N.Y. 1984).

Hancock exercised unfettered control over the value of GAC 50 by locking in substantial free funds into Hancock's General Account. Hancock's complete discretion with respect to its own compensation, in the face of which the Plan can only sit idly by and hope for the best, presents precisely the unconscionable scenario that ERISA was intended to prevent. While the Seventh Circuit has appropriately upheld these integral fiduciary provisions in virtually identical situations, the Second Circuit has erred in its failure to properly construe ERISA. The Second Circuit's decision leaves open the possibility that any insurance company can evade its fiduciary obligations simply by inserting discretionary terms into those contracts which, like other insurance contracts and policies, are largely contracts of adhesion.

II.

HANCOCK IS AN ERISA FIDUCIARY WITH RESPECT TO ALL OF THE ASSETS IT HOLDS UNDER GAC 50

The Second Circuit correctly held that the free funds held by Hancock are "plan assets," the discretionary management of which subjects Hancock to ERISA.[9] Nevertheless, the decision did not go far enough. As discussed below, all of the funds held by Hancock are invested by Hancock for the purpose of generating free funds, which are not associated with any benefits guaranteed by Hancock. Since 1968, no traditional annuities were ever purchased from Hancock; both guaranteed and non-guaranteed benefits were paid directly from the PA fund. Therefore, all such funds are subject to investment risk and all are plan assets governed by ERISA's fiduciary responsibility rules.

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[9] This portion of the opinion below is the subject of Hancock's Petition for a Writ of Certiorari dated December 22, 1992.

As of 1991, the insurance industry held over 500 billion dollars in pension assets in general account contracts, most commonly under the type of contract here in issue. Amicus Brief of the American Council of Life Insurance, submitted on appeal below, dated August 13, 1992. Thus, the issue presented here is of enormous significance in that potentially hundreds of billions of dollars in pension assets may be left beyond the scope of ERISA protection.

A. The Relevant Statutory Provisions

ERISA defines a fiduciary as:

> [A] person is a fiduciary with respect to a plan to the extent . . . he exercises any discretionary authority or discretionary control respecting management of such plan or *exercises any authority or control respecting management or disposition of its assets*. . . .

29 U.S.C. § 1002(21)(A) (emphasis added). A-93. Congress adopted a limited "safe harbor" provision in ERISA for certain pension fund assets held in insurance company general accounts:

> In the case of a plan to which a *guaranteed benefit policy* is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, *solely* by reason of the issuance of such policy, be deemed to include any assets of the insurer.

29 U.S.C. § 1101(b)(2) (emphasis added).[10] A-94. "Guaranteed benefit policy" is defined in the statute as: "an insurance policy or contract *to the extent that* such policy or contract provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. § 1101(b)(2)(B) (emphasis added). A-94.

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[10] A provision in the Senate Bill would have explicitly exempted *all* assets held in general accounts from ERISA's fiduciary duty provisions. *See* S.4, 93d Cong., 1st Sess. § 511 (1973), *reprinted in* 1 Legis. Hist. of ERISA at 170 (Comm. Print 1976). This provision was deleted and replaced by the more limited "guaranteed benefit policy" exemption. 29 U.S.C. § 1101(b)(2).

In enacting ERISA Congress intended to make a distinction between funds held under "guaranteed benefit policies" and funds held under other insurance company general account pension contracts.[11] In using the term "guaranteed benefit policy," Congress recognized a distinction between those insurance company general account contracts which truly guarantee benefits to retirees, and those like GAC 50 which participate in the insurer's investment experience. The ERISA Conference Report states:

> If the policy guarantees basic payments but other payments may vary with, e.g., investment performance, then *the variable part of the policy and assets attributable thereto* are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules.

H. Rep. No. 93-1280, 93d Cong., 2d Sess. (1974), *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5077 (emphasis added) ("ERISA Conf. Rep.").

Thus, the crucial question in determining whether assets invested by the Plan are "plan assets" is whether the availability of funds for benefits is dependent upon Hancock's success or failure as an investor, rather than upon any role it may have as an insurer. Following this standard, all of the assets held by Hancock under GAC 50 are clearly "plan assets."

First, because the assets backing the guarantees are invested by Hancock in order to generate additional free funds, all of the funds held by Hancock are also plan assets and thus Hancock's discretionary management of such funds subjects it to

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[11] Under ERISA all pension plan assets held in separate accounts are "plan assets" and therefore subject the insurance company to the full panoply of ERISA's fiduciary duty provisions. *See* 29 U.S.C. § 1101(b)(2)(B). Separate accounts are investment funds which are permitted to invest in different types of assets than general accounts. *See, e.g.*, N.Y. Ins. Law § 4240(a)(2)(A)(McKinney 1991). Many separate accounts are used exclusively by pension plans.

ERISA's fiduciary rules. Second, because Hancock has chosen to commingle assets backing its guarantees with those representing free funds, it must assume fiduciary responsibilities with respect to all such funds.

The amount in GAC 50's PA Fund available to fund benefits is dependent upon the investment experience of the Hancock General Account and allocation of that experience to the PA Fund. A-5. The monies allegedly supporting benefits "guaranteed" by Hancock and the "free money" which may be used to provide future guaranteed or non-guaranteed benefits are all held in the PA Fund, and it is the entire PA Fund which receives the benefits and detriments of Hancock's investment performance. J.A. 1641-1674 (the 68 Amendment). Indeed Hancock's own experts agreed with the characterization of contracts such as GAC 50 as "investment vehicles." J.A. 591-96.

The funds supporting the benefits "guaranteed" by Hancock and the "free funds" in excess of the Minimum Level are commingled and invested together by Hancock. The *entire* fund earns income and generates additional "free funds." Thus, the monies held by Hancock under GAC 50 should not be compartmentalized into those supporting a "guaranteed benefit policy" and those supporting variable aspects of the contract. Furthermore, since the earnings on the Contingency Account are also credited to the PA Fund and contribute to the generation of "free funds" which support non-guaranteed benefits and any future guaranteed benefits, the funds in the Contingency Account are also plan assets.

Because Hancock does not attempt to segregate the variable, non-guaranteed portion of GAC 50's funds, the entire PA Fund and Contingency Account should fall within the broad remedial requirements of ERISA's fiduciary responsibility provisions. *See, e.g., Smith v. CMTA-IAM Pension Trust*, 746 F.2d 587 (9th Cir. 1984). Accordingly, as in *Peoria*, the entire PA Fund should be considered to be in the "variable accumulation phase," thereby subjecting Hancock to ERISA's fiduciary duty provisions.

B. The Seventh Circuit And The *Jacobson* Court Correctly Read ERISA As Protecting Assets Which Are Subject To Investment Fluctuations Under Contracts Like GAC 50

In *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Insurance Co.*, 698 F.2d 320, 327 (7th Cir. 1983), the Seventh Circuit set forth for the first time the theoretical basis for holding an insurer to fiduciary standards with respect to its management of general account funds.

Peoria involved a deposit administration fund ("DA Fund") in which pension funds were "commingled for investment purposes with the funds of other customers of the insurance company, in much the same way as investments of different investors are pooled in a mutual fund or common trust fund, in order to obtain diversification while minimizing brokerage and management costs." 698 F.2d at 322. Once an employee retired, annuities were purchased and the purchase price for such annuities was removed from the DA Fund account. The DA Fund no longer received the benefit of the insurer's investment experience on the funds so removed. Thus, no payments to beneficiaries were made from the DA Fund.

In such circumstances, the Seventh Circuit held that, while the funds in issue were kept in the DA Fund, the contract was in a variable accumulation phase and did not constitute a "guaranteed benefit policy," because the insurer had investment discretion and the results of that investment discretion would determine the amount of funds available to the pension plan:

> The pension trustees did not buy an insurance contract with a fixed payout; they turned over the assets of the pension plan to [the insurance company] to manage with full investment discretion, subject only to a modest income guaranty. If the pension plan had hired an investment advisor and given him authority to buy and sell securities at his discretion for the plan's account, the advisor would be a fiduciary within the

> meaning of the act, and that is essentially what the Trustees did during the accumulation phase of the contract with [the insurance company].

698 F.2d at 327.

The *Peoria* court found that the minimal guarantees of investment return made by the insurance company (declining from 7½ to 3½ percent in the first three years and none thereafter) were not meaningful. *Id.* at 324-25. The investment return guarantees in GAC 50 are far lower than those in the *Peoria* contract. The only investment guarantee in GAC 50 is a meaningless so-called "guarantee of principal" which in fact does not guarantee principal. Hancock itself, in describing GAC 50, has repeatedly stated, "[T]he nature of the funding medium places the *employer* [now the plan] on the risk for the plan experience." J.A. 271, 293, 316, 333, 350, 366, 382, 399 and 428.

In *Peoria*, the contract separated the assets supporting guaranteed benefits from those in the non-guaranteed accumulation phase. That is not true of GAC 50. Therefore, because all of the pension funds held under GAC 50 are held and invested in such a way that the entire PA Fund generates investment income for the Plan, the PA Fund should not be bifurcated for the purpose of determining Hancock's fiduciary duties. Hancock, unlike the insurer in *Peoria*, should be held to fiduciary standards with respect to all of the assets held under GAC 50.

The principles articulated in *Peoria* as described above have been applied in the context of a contract nearly identical to GAC 50. *Jacobson v. John Hancock Mut. Life Ins. Co.*, 655 F. Supp. 1290, withdrawn pursuant to settlement, 662 F. Supp. 1103, 1112-13 (D. Conn. 1987). In *Jacobson*, the plaintiff pension plan trustees alleged that Hancock was a fiduciary with respect to the contract and the funds held thereunder. The *Jacobson* court granted partial summary judgment holding that Hancock was an ERISA fiduciary as to all of the funds held under that contract. Hancock then settled with the trustees and the opinion was withdrawn pursuant to that settlement.

Initially, the *Jacobson* court noted that the guaranteed benefit policy exemption "does indeed provide a safe harbor to insurance companies that sell *standard annuity* contracts. . . ." 662 F. Supp. at 1107 (citing *Peoria*) (emphasis added). *Jacobson*, however, following the reasoning of *Peoria*, rejected the argument that *all* of the funds held under the contract enjoyed this "safe harbor." The court held that the contract was *not* a "guaranteed benefit policy" while "the level of funds available to support benefits which may become due fluctuates with the investment return of the insurer." 662 F. Supp. at 1108.

The PA Fund here, like its counterpart in *Jacobson*, "fluctuates with the investment return of the insurer," and thus is not a guaranteed benefit policy.

The *Jacobson* decision argues forcefully for this result:

> [U]nlike the guaranteed annuity contract, benefits of any or all participants are not guaranteed under GAC 738 so long as the fund contributions are subject to the investment results achieved by the insurer. Poor investment results might reduce or even exhaust funds below the level sufficient to pay benefits as they become fixed and payable. It is this contingency which § 1101(b)(2) addresses. That section must be read as written, vis [sic], to cover only that phase of a contract in which the obligation of the insurer to guarantee the benefits payable to plan participants is fixed. To construe the language "to the extent that" to apply to all stages of GAC 738 would exonerate defendant from the fiduciary obligation while it is managing and investing the plan contributions, when it has not guaranteed participants' benefits and while the contributions are subject to the risks of its investment decisions. Performance of aspects of a plan which does not guarantee benefit payments or a fixed rate of return, but provide [sic] for the insurer's management of the assets until they are converted to a guarantee of the payment of benefits, cannot be sheltered under this section.

Jacobson, 662 F. Supp. at 1108.

This analysis is supported by rulings of the Department of Labor ("DOL"), which is charged with enforcement of the fiduciary provisions of ERISA. For example, the DOL has clearly employed the distinction between "guaranteed" and variable payments to distinguish between funds which are plan assets and those which are not. The DOL has stated,

> [A] separate account would not hold "plan assets" for purposes of the fiduciary responsibility provisions of ERISA if it is maintained by an insurance company solely in connection with its fixed contractual obligations and if neither the *amount payable to* (or credited to) *the plan* or to any participant or beneficiary of the plan (including an annuitant) *is affected in any way by the investment performance of the separate account*. We note, however, that a conventional separate account (which holds contributions received from a plan and provides for the crediting of income on such amounts based upon the investment experience of the separate account) *would not be considered to be maintained in connection with a fixed contractual obligation of the insurance company merely because assets of the separate account are ultimately applied to provide fixed annuities to participants*, and the assets of such a separate account would be considered to be plan assets.

DOL Advisory Opinion 83-51A (Sept. 21, 1983) (emphasis added). The crucial distinction is thus whether the insurance company exercises *investment control* and whether the insurance company's investment performance affects the amount of funds available to the Plan and its participants.[12]

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[12] In Advisory Opinion 78-8, the DOL stated that:

> The [Conference Report on section 1101(b)(2) of ERISA] evidences a Congressional intent that when an insurance company provides

(Footnote continued)

At least two important points are revealed by 83-51A. First, it is clear that the DOL considers significant "the extent to which" investments in separate accounts are *actually* "*guaranteed*." Second, the DOL has recognized that the mere fact that fixed annuities will eventually be purchased with assets from an account does *not* make the entire policy a "guaranteed benefit policy" for purposes of the exemption in § 1101(b). A-12.

Clearly, all of the assets held by Hancock under GAC 50 are invested in Hancock's sole discretion and all such assets support the non-guaranteed aspects of the contract. Thus, all such assets should be held to be "plan assets" as to which Hancock bears fiduciary responsibility.

C. GAC 50 Is Not An Insurance Policy Because Hancock Bears No Meaningful Risks

In any event, § 1101(b)(2)(B)'s safe harbor should not apply because GAC 50 is an investment contract, not an insurance policy. Hancock sold the 68 Amendment on the basis that it was an investment vehicle,[13] J.A. 273-80, 252-55, and Hancock's own expert witnesses recognized that contracts such as GAC 50 are promoted by the insurance industry as *investment vehicles*. J.A. 591-96. A review of GAC 50's so-called guarantees shows that Hancock bears no meaningful risk. Therefore, GAC 50 is not an "insurance policy or contract," much less a "guaranteed benefit policy." As this Court has pointed out, there is "a basic

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> investment advice which determines the rate of return to the plan and its participants, the assets in the account shall constitute plan assets so that the insurance company is subject to the fiduciary responsibility provisions of the Act.

DOL Advisory Opinion 78-8A (Mar. 13, 1978).

[13] In the securities law area, courts have long analyzed insurance products to determine whether they are either insurance policies or investment contracts. *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 71 (1959); *Otto v. Variable Annuity Life Ins. Co.*, 814 F.2d 1127 (1986), as amended on rehearing, 814 F.2d at 1140 (7th Cir. 1987), *cert. denied*, 486 U.S. 1026 (1988).

difference between a contract which is to some degree insured and a contract of insurance". *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967).

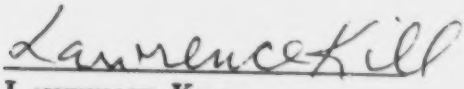
The notion that there is any meaningful investment risk to Hancock under GAC 50 is groundless. The LOF investment return assumptions contained in GAC 50 for the pre-68 annuities are 2.5 and 3 percent. As a matter of basic economics, this means that Hancock assumed no investment risk under the Contract and has not since before ERISA was enacted in 1974. The Seventh Circuit in *Peoria* found, with much higher investment guarantees, no investment risk. *Peoria*, 698 F.2d at 324-25.

CONCLUSION

For all the foregoing reasons, Harris Trust respectfully requests that the Court issue a writ of certiorari as prayed for herein to review the judgment of the United States Court of Appeals for the Second Circuit.

Dated: New York, New York
January 21, 1993

Respectfully submitted,



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(2)

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HARRIS TRUST AND SAVINGS BANK,
as Trustee of the Sperry Master Retirement Trust No. 2,

Cross-Petitioner,

v.

JOHN HANCOCK MUTUAL LIFE
INSURANCE COMPANY,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION TO CROSS-PETITION FOR A WRIT OF CERTIORARI

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Parties

The parties to the action below were Cross-Respondent John Hancock Mutual Life Insurance Company ("Hancock"); Cross-Petitioner Harris Trust and Savings Bank ("Harris Trust"); counterclaim defendant Chase Manhattan Bank, N.A. ("Chase"), which was succeeded as trustee of the Sperry Master Retirement Trust No. 2 on October 1, 1987, by Harris Trust; and third-party defendants Sperry Corporation ("Sperry") and The Retirement Committee of Sperry Corporation ("Sperry Retirement Committee").

Hancock is a mutual insurance company; it does not have any parent companies or subsidiaries to list pursuant to Rule 29.1.

In 1986, Sperry merged with Burroughs Corporation and became Unisys Corporation ("Unisys"). The Sperry Retirement Committee was succeeded by the Unisys Pension Investment Review Committee. Hancock is informed and believes that shares of Unisys and shares of Chase are publicly traded. Additionally, petitioner is informed and believes that Harris Trust is acting as a party only in its capacity as trustee of the Sperry Master Retirement Trust No. 2 and is not otherwise affected by the outcome of this litigation, and that the Bank of Montreal is a parent of Harris Trust.

Hancock is not aware of any other parent companies or subsidiaries to list pursuant to Rule 29.1.

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No. 92-1259

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HARRIS TRUST AND SAVINGS BANK,
as Trustee of the Sperry Master Retirement Trust No. 2,

Cross-Petitioner,

v.

JOHN HANCOCK MUTUAL LIFE
INSURANCE COMPANY,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION TO CROSS-PETITION FOR A WRIT OF CERTIORARI

Cross-Respondent John Hancock Mutual Life Insurance Company ("Hancock")[1] submits this brief in opposition to the Cross-Petition for a Writ of Certiorari of Harris Trust and Savings Bank ("Harris Trust"). For the reasons stated herein, the Cross-Petition should be denied.

[1] The opinions of the courts below are reproduced in the Appendix to the Petition for a Writ of Certiorari in Docket No. 92-1074. References to pages of that Appendix are cited herein as "A- ", followed by the page number.

Reasons for Denying the Cross-Petition

Neither question presented by Harris Trust in its Cross-Petition warrants review by this Court. Apart from the question presented by Hancock in its Petition for a Writ of Certiorari in Docket No. 92-1074, the decision of the Second Circuit:

(1) does not conflict with any decision of another court of appeals;

(2) is not inconsistent with ERISA[2] or its legislative history;

(3) is not inconsistent with any interpretation of ERISA published by the Department of Labor (the "DOL"); and

(4) does not involve a novel or innovative interpretation of the statute or existing law.

In addition, it is not necessary for the Court to grant the Cross-Petition in order to consider fully the issues raised by Hancock in its Petition. The question there presented, *viz.*, whether ERISA's fiduciary responsibility provisions apply to any of the assets held by insurance companies in their General Accounts under group annuity contracts that provide for guaranteed benefits, is of fundamental significance to the insurance industry and state insurance regulators.[3] The questions presented by the Cross-Petition, however, raise separate and distinct issues.

Though couched in deceptively ambiguous language, the Cross-Petition in essence seeks review of the following questions:

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[2] Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.* ("ERISA").

[3] That question merits review, because the Second Circuit decision, in the one respect in which it reversed the district court, (i) misconstrues ERISA's "guaranteed benefit policy" exception, (ii) directly conflicts with decisions of other courts of appeals, (iii) contradicts 18 years of consistent regulatory interpretation of the statute by the DOL, (iv) has created substantial confusion and uncertainty in the insurance industry, (v) threatens disruption of long-standing insurance company business practices, (vi) ignores Congress' allocation of responsibility for regulating the business of insurance to the States and (vii) unless reversed, will institute a regime of federal regulation of insurance company assets that conflicts with the existing framework of state regulation of insurance.

(1) whether an insurance company should be deemed a fiduciary under ERISA by reason of its exercise of its contract rights under a group annuity contract with a pension plan; and

(2) whether all the assets held by an insurance company in its General Account under a typical group annuity contract like GAC 50 – not just those assets that are "not referable to guaranteed benefits" – are subject to ERISA's fiduciary rules.

Each of these extraordinary propositions was rejected by the court below, is inconsistent with ERISA and its legislative history, and has thus far found no support in any judicial decision. The questions in the Cross-Petition, therefore, do not merit this Court's review.

I.

THE CONTENTION THAT HANCOCK SHOULD BE DEEMED A FIDUCIARY UNDER ERISA WITH RESPECT TO GAC 50 ITSELF DOES NOT MERIT REVIEW

Harris Trust argues that Hancock must comply with ERISA's fiduciary standards even when exercising its own contract rights under GAC 50, on the theory that the contract is a "plan asset" and that Hancock has "broad and unfettered discretion to alter Harris Trust's rights" under GAC 50. Cross-Petition at 8. It contends, therefore, that Hancock, even in exercising its own rights under the contract, must act exclusively for the benefit of the Plan.

Affirming the district court, the Second Circuit held that, while the contract itself is a "plan asset," Hancock is not a fiduciary in relation to the contract *qua* contract:

> The policy itself, with its bundle of contractual rights and responsibilities, therefore is similar to any other financial instrument owned by an employee benefit plan. Hancock is not a fiduciary in regard to the policy here, however, because it does not 'exercise[ ] any discretionary authority or discretionary control . . . respecting management or disposition of' the policy itself. 29 U.S.C. § 1002(21)(A). Only Harris Trust as

> contractholder has discretionary authority over the guaranteed benefit policy *qua* policy.

(A-13)* The court concluded that Hancock "has no fiduciary responsibility in regard to the undivided policy" (A-14).

Contrary to Harris Trust's assertion in its Cross-Petition, the Second Circuit's decision on this issue is not in conflict with the decisions of the Seventh Circuit or of any other circuit court. Rather, its decision on this point has broad judicial support and does not change existing law.

A. *There Is No Conflict Between the Second Circuit's Decision and the Decisions of Other Circuit Courts.*

The Cross-Petition is predicated upon a supposed conflict between the decision below and two decisions of the Seventh Circuit, *Ed Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732 (7th Cir. 1986), *cert. denied*, 482 U.S. 915 (1987), and *Chicago Bd. Options Exchange, Inc. v. Connecticut Gen'l Life Ins. Co.*, 713 F.2d 254 (7th Cir. 1983) ("*CBOE*"). The Second Circuit properly found, however, that *Miniat* and *CBOE* are inapposite (A-14). Moreover, even cursory analysis of *Miniat* and *CBOE* shows that neither supports the broad proposition advanced by Harris Trust, *viz.*, that ERISA's fiduciary rules apply to an insurance company's exercise of its rights under the contract.

In both *Miniat* and *CBOE*, the insurance company defendant allegedly had exercised a unilateral right to alter a critical

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* The Second Circuit found clear support for its conclusion in ERISA's legislative history. The Joint Explanatory Statement of the Committee on Conference had noted:

> A trust is not to be required in the case of plan assets which consist of insurance (including annuity) contracts or policies issued by an insurance company qualified to do business in a State (or the District of Columbia) . . . . Although these contracts need not be held in trust, nevertheless, *the person who holds the contract is to be a fiduciary and is to act in accordance with the fiduciary rules . . . with respect to these contracts.*

H.R. Rep. No. 1280, 93d Cong., 2d Sess., *reprinted in* 1974 U.S. Code Cong. & Admin. News 5038, 5079 (emphasis added).

contract term that resulted in severe prejudice to the contractholder.[5] Neither decision is on point, because, as the Second Circuit found, under GAC 50, Hancock "can act only under the terms of the policy, and any change in the policy requires the consent of the contractholder" (A-14). Both the Second Circuit and the district court concluded that Hancock did not alter any terms of the contract but merely "exercised its express rights under the contract" (A-14).[6] Whether or not *Miniat* and *CBOE* are correct applications of ERISA to the facts of those cases, they are not germane to the facts in this case.

In any event, *Miniat* and *CBOE* do not support the broad proposition advanced by Harris Trust that an insurer should be deemed a fiduciary when it performs in accordance with the specific terms of a contract. Indeed, the Seventh Circuit has itself

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[5] In *CBOE*, the insurer allegedly amended provisions of the contract unilaterally with the effect of deferring for a ten-year period the right the contractholder theretofore had to withdraw or transfer funds under the contract, thereby altering the contract in a way that "lock[ed] CBOE into the [contract] for the next 10 years . . . [and] determined what type of investment the Plan must make." 713 F.2d at 260. Similarly, in *Miniat*, in reversing a dismissal on the pleadings on the strength of an allegation that the defendant "'unilaterally . . . announced a withdrawal from the [Retirement Life Reserve] insurance business and an abandonment of existing policy holders, by reducing the rate of return paid on account from 10% to 7% to 4% per annum by November 1, 1983, and increasing premium rates to the maximum allowed by the policy,'" 805 F.2d at 734, the Seventh Circuit held that "plaintiff *may* be able to prove that [defendant] is a fiduciary," *id.* at 738 (emphasis added).

[6] With regard to the specific conduct challenged by Harris Trust (Cross-Petition at 8), the district court found in *Harris II*, on the undisputed facts before it, that Hancock's conduct was consistent with both the terms of the contract and state law and granted summary judgment dismissing all such claims. The district court held that Hancock had no contract obligation whatsoever to continue to make available the so-called "rollover" arrangement (A-67 to A-71); Harris Trust did not appeal from the dismissal of that claim. Next, the district court held that Hancock had the express right under the contract to terminate so-called "non-guaranteed benefit" payments (A-71 to A-77); on appeal, the Second Circuit affirmed (A-16 to A-18). Finally, the district court found that Hancock performed the allocation of investment income and expenses in accordance with the contract's terms, *viz.*, on a company-wide basis pursuant to procedures approved by the New York State Insurance Department (A-83 to A-85); Harris Trust did not appeal from the dismissal of that claim.

ruled that in those circumstances an insurer does not have an ERISA fiduciary duty. *See Schulist v. Blue Cross of Iowa*, 717 F.2d 1127 (7th Cir. 1983). As the Seventh Circuit explained in *Miniat*:

> *Schulist* stands for the proposition that if a specific term (not a grant of power to change terms) is bargained for at arm's length, adherence to that term is not a breach of fiduciary duty. No discretion is exercised when an insurer merely adheres to a specific contract term.

805 F.2d at 737. *See also Associates in Adolescent Psychiatry, S.C. v. Home Life Ins. Co.*, 941 F.2d 561, 569 (7th Cir. 1991) (*CBOE* "held that an insurer's authority to amend the terms of an annuity contract purchased to fund a retirement plan makes it a fiduciary under 29 U.S.C. § 1002(21)(A)"), *cert. denied*, 112 S. Ct. 1182 (1992). Harris Trust has been unable to cite any authority in the Seventh Circuit or any other circuit that holds to the contrary.

To obscure its patent lack of any supporting authority, Harris Trust suggests that this case involves an insurer's exercise of discretion that "alters the pension plan's rights under the contract or the value of the contract to the plan." Cross-Petition at 3. The conduct challenged by Harris Trust, however, does not involve an alteration of the terms of GAC 50 but rather actions consistent with the terms of the contract.[7] As the court below held, none of these actions could be construed as altering or amending any of Harris Trust's rights under the contract or involved "a grant of power to change terms." These actions merely reflected an exercise by Hancock of its "express rights under the contract" (A-14), and there is no authority in any circuit that holds that the exercise of such rights implicates ERISA fiduciary duties.[8]

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[7] *See supra* note 5.

[8] Harris Trust also argues that Hancock's exercise of its contract rights constitutes an increase in Hancock's "compensation." Cross-Petition at 11. Hancock disputes that characterization as a factual matter, and there is no support for such a conclusion in the record. In any event, as the Seventh Circuit noted in *Schulist*, adherence to the contract, even in matters of compensation, does not render an insurer a fiduciary. 717 F.2d at 1132. Harris Trust cites *F.H. Krear & Co. v. Nineteen Named Trustees*, 810 F.2d 1250, 1259 (2d Cir. 1987), to support

(Footnote continued)

B. *Harris Trust's Contention Is in Conflict with Numerous Decisions in Other Circuits.*

Harris Trust also seeks review on the ground that the decision below changes existing law and "has opened an enormous gap in the protections afforded by ERISA's fiduciary rules." Cross-Petition at 7. On the contrary, the Second Circuit's decision is consistent with a substantial body of judicial authority that holds that ERISA was not intended to place a person dealing with a pension plan in the position of having conflicting obligations.

Harris Trust's theory, if adopted, would have profound implications for insurance company operations. A General Account contract like GAC 50 typically affords the insurer a variety of contract rights to which the contractholder has expressly agreed. Those rights are specifically set forth in the contract and are designed to benefit not just the insurer but all its other General Account contractholders. For example, GAC 50, as well as Hancock's other participating group annuity contracts, requires that Hancock employ company-wide procedures, such as income and expense allocations and dividend formulae, that simultaneously affect thousands of contracts backed by the General Account. Hancock is obligated, of course, both under contract terms and by an extensive body of state laws and regulations, to establish those procedures and apply them in a manner that is nondiscriminatory as to pension plan and non-pension plan customers alike. If, as Harris Trust contends, an insurer's conduct is to be governed by ERISA's "solely in the interest of" standard when it executes such procedures, it would be subjected to irreconcilably conflicting duties.

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its argument. *Krear* is of no help to Harris Trust, however, because that case held that the defendants were *not* ERISA fiduciaries, inasmuch as they had no fiduciary responsibilities in fixing the terms of an agreement with the pension plan involved, including the terms relating to their compensation. *Id. Krear* noted, in *dictum*, that a party to a contract *may* have such control over factors that affect its compensation, like the percentage of claims paid, so as to become a fiduciary with respect to compensation. *Id. Krear* did not suggest, however, that a party to a contract would become a fiduciary under ERISA whenever it had discretion in connection with the exercise of its contract rights.

The courts in a number of circuits have held that Congress did not intend to impose ERISA's fiduciary duties in a manner that would create conflicting obligations.[9] In *Useden v. Acker*, for example, the Eleventh Circuit, rejecting a claim that a commercial lender to a plan acts as a fiduciary in exercising its rights under the loan agreement, recognized that such conduct, while affecting the interests of the plan, also affects the interests of the lender's shareholders and depositors:

> We cannot agree with appellant's claim that the bank's mere exercise of its contractual rights made the bank an alter ego of the named Plan fiduciaries. . . .
>
> To accept appellant's theory would subject any commercial lender acting within ordinary commercial custom to inconsistent obligations. On the one hand, a bank's duty to its shareholders and depositors would demand that it enter into only those agreements which accord it sufficiently exacting security rights. On the other hand, a bank's resulting fiduciary duty to the plan-borrower would irreconcilably preclude its exercise of those crucial rights.

947 F.2d 1563, 1575 (11th Cir. 1991), *petition for cert. filed sub nom. Useden v. Greenberg Traurig Hoffman Lipoff Rosen & Quentel*, 60 U.S.L.W. 3843 (U.S. June 1, 1992) (No. 91-1944).[10] The reasoning of *Useden* and of these other cases applies with equal force here.

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[9] *See, e.g., Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980); *United Indep. Flight Officers, Inc. v. United Air Lines, Inc.*, 756 F.2d 1262, 1268 (7th Cir. 1985); *see also Hagan v. Kaiser Aluminum & Chem. Corp.*, 668 F. Supp. 1298, 1301 (E.D. Mo. 1987); *Amato v. Western Union Int'l, Inc.*, 596 F. Supp. 963, 968 (S.D.N.Y. 1984), *aff'd in part, rev'd in part*, 773 F.2d 1402 (2d Cir. 1985), *cert. dismissed*, 474 U.S. 1113 (1986); *Sutton v. Weirton Steel Div. of Nat'l Steel Corp.*, 567 F. Supp. 1184, 1201 (N.D. W. Va.), *aff'd*, 724 F.2d 406 (4th Cir. 1983), *cert. denied*, 467 U.S. 1205 (1984).

[10] The questions presented in the pending Petition for Writ of Certiorari in *Useden* do not affect the proposition for which that case is cited here. Those questions concern whether ERISA authorizes a monetary remedy against a non-fiduciary who knowingly participates in a fiduciary's breach of duty. *See* 61 U.S.L.W. 3093 (U.S. Aug. 11, 1992).

An insurer does not act in a fiduciary capacity when it exercises its rights under a General Account group annuity contract, because it cannot act "solely in the interest of" any one contractholder without simultaneously breaching its obligations to its other contractholders. The Second Circuit's holding merely confirmed the conclusion reached by all the other courts that have considered this issue.

II.

THE CONTENTION THAT HANCOCK IS SUBJECT TO ERISA FIDUCIARY DUTIES WITH RESPECT TO ALL THE ASSETS HELD UNDER GAC 50 DOES NOT MERIT REVIEW

Having persuaded the court below that Hancock should be subject to ERISA fiduciary duties with regard to the "free funds" under GAC 50, Harris Trust now claims that the Second Circuit "did not go far enough." Cross-Petition at 12. It contends that the Second Circuit should have held that Hancock is a fiduciary with regard to all the assets under GAC 50. Cross-Petition at 3. Despite Harris Trust's assertions to the contrary, no circuit court has gone that far. There is no conflict, therefore, and no other reason why this Court should grant review.

A. *The Second Circuit's Decision Does Not Conflict with the Decision of Any Other Circuit Court.*

The Second Circuit rejected Harris Trust's contention that Hancock should be considered a fiduciary with respect to all the assets held under GAC 50. Rather, it found that "Hancock provides guarantees with respect to one portion of the benefits derived from the contract" (A-8 to A-9) and that,

> *at least to the extent it provides for benefits guaranteed by Hancock, GAC 50 is a guaranteed benefit policy* and Hancock does not act as a fiduciary in administering it.

(A-8) (emphasis added). Contrary to Harris Trust's contention, that determination is not inconsistent with the opinions in *Peoria Union Stock Yards Co. Ret. Plan v. Penn Mut. Life Ins. Co.*,

698 F.2d 320 (7th Cir. 1983), and *Jacobson v. John Hancock Mut. Life Ins. Co.*, 662 F. Supp. 1103, *withdrawn, set aside & vacated*, 662 F. Supp. 1112 (D. Conn. 1987), the two decisions ostensibly in conflict with the decision below.[11] In any event, the opinions in *Peoria Union* and *Jacobson* are of limited precedential value, as even the courts that issued them recognized.

Peoria Union involved a contract which the Seventh Circuit described, on the basis of the pleadings before it, as one that (unlike GAC 50) did not provide guarantees with respect to any of the benefits derived from the contract.[12] Instead, the contract was said to involve a so-called "accumulation phase" during which the insurer did not guarantee any benefits. 698 F.2d at 327. As described by the Seventh Circuit, the employer could use funds accumulated in that phase to purchase annuities from the defendant insurance company or withdraw them to purchase the annuities from another insurer. *Id.* at 322. The employer had in fact withdrawn funds to purchase annuities on behalf of retired employees. *Id.* at 323.

The sole issue considered in *Peoria Union* was whether the "guaranteed benefit policy" exception applied to the funds held by the insurer during the "accumulation phase." It did not address whether the exception applied in any respect to benefits guaranteed under the contract or to the annuities purchased with funds withdrawn from the contract.

While the Second Circuit found that GAC 50 has at all times had "free funds," *i.e.*, assets that the court characterized as "not referable to guaranteed benefits," it is undisputed that GAC 50

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[11] *Peoria Union* and *Jacobson*, to the extent that they hold that an insurance company has any fiduciary duty with respect to a General Account contract that provides for guaranteed benefits, are substantively incorrect for the reasons stated in *Mack Boring and Parts Corp. v. Meeker Sharkey Moffitt*, 930 F.2d 267 (3d Cir. 1991), and urged by Hancock in its Petition in Docket No. 92-1074.

[12] *Peoria Union* involved an appeal from the district court's dismissal of the complaint on the ground that it did not state a claim for relief under ERISA. 698 F.2d at 328. The Seventh Circuit reversed, holding that a claim for ERISA had been stated. *Id.* at 327.

also contained substantial assets supporting guaranteed benefits (A-8).[13] *Peoria Union* does not conflict with the decision below, therefore, because it does not address ERISA's applicability to that portion of a group annuity contract that supports guaranteed benefits.[14]

Harris Trust's argument, to the extent that it relies upon *Peoria Union*, fails for other reasons as well. Upon motion for rehearing, the Seventh Circuit expressly acknowledged the limited nature of its opinion, which "merely reverse[d] the dismissal of the complaint," and it reserved judgment on a "number of arguments" concerning ERISA's applicability that the court had not considered. 698 F.2d at 328. The Seventh Circuit's candid statement that its opinion should not be regarded as dispositive of ERISA's applicability to the contract at issue diminishes whatever precedential value it might otherwise have.

For similar reasons, *Jacobson*, a district court decision within the Second Circuit, does not support Harris Trust's contention. Like *Peoria Union*, *Jacobson* involved the question whether the insurance company defendant — Hancock — was an ERISA fiduciary with respect to assets held under a group annuity contract that were not associated with guaranteed benefits.

Jacobson did not, as Harris Trust asserts, hold that "Hancock was an ERISA fiduciary as to all of the funds held under the

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[13] In its Brief in Opposition to Petition for a Writ of Certiorari ("Opposition Brief") in Docket No. 92-1074, Harris Trust acknowledged that "Hancock provides guarantees with respect to one portion of the benefits derived from the contract." Opposition Brief at 3.

[14] Harris Trust conceded as much in its Opposition Brief in Docket No. 92-1074. There, it stated:

> In *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mut. Life Ins. Co.*, 698 F.2d 320, 327 (7th Cir. 1983), the Seventh Circuit recognized that group annuity contracts such as GAC 50 can be divided into guaranteed and non-guaranteed aspects for purposes of an ERISA analysis. In *Peoria*, the Seventh Circuit concluded that the non-guaranteed portion of the contract was governed by ERISA.

Opposition Brief at 5.

contract." Cross-Petition at 17. Quite the opposite: *Jacobson* held that the "guaranteed benefit policy" exception covers "that phase of a contract in which the obligation of the insurer to guarantee the benefits payable to plan participants is fixed." 662 F. Supp. at 1108. Thus, *Jacobson* is flatly contrary to Harris Trust's argument.[15]

Jacobson lacks significance for other reasons as well. To begin with, *Jacobson* is only a decision of a district court within the Second Circuit. The law of the Second Circuit is expressed in the decision below, not in *Jacobson*. *Jacobson* cannot properly be used, therefore, to support Harris Trust's claim that there is a "conflict" between the circuits. Finally, the *Jacobson* decision lacks any precedential value, because it was subsequently withdrawn and vacated by the district court.[16]

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[15] Harris Trust correctly characterized *Jacobson* in its Opposition Brief in Docket No. 92-1074:

> The principles articulated in *Peoria* have also been applied in the context of a contract nearly identical to GAC 50. *Jacobson v. John Hancock Mut. Life Ins. Co.*, 655 F. Supp. 1290, withdrawn pursuant to settlement, 662 F. Supp. 1103, 1112-13 (D. Conn. 1987). In *Jacobson*, the pension plan trustees alleged and the Court held that Hancock was an ERISA fiduciary with respect to funds held under a contract *which were not associated with guaranteed benefits.*

Opposition Brief at 6 (emphasis added).

[16] In entering its order vacating its prior decision, the district court noted that "there are genuine issues with respect to whether, in enacting ERISA, Congress intended that insurance companies be deemed to be fiduciaries, as defined by ERISA, with respect to assets contributed pursuant to group annuity contracts and held in their general investment accounts . . . ." 662 F. Supp. at 1113. The district court directed that its previous decision,

> together with the findings and conclusions therein, [be] withdrawn, set aside and vacated, and shall be of no force or effect for use against defendant, its successors and assigns, by plaintiffs, by the Pension Fund or by third parties, for collateral estoppel or other preclusive purposes. . . .

Id.

B. *Harris Trust's Contention Is Wholly at Variance with the "Guaranteed Benefit Policy" Exception.*

Harris Trust argues that the Second Circuit's decision misconstrues ERISA's "guaranteed benefit policy" exception. The Second Circuit expressly found that "Hancock provides guarantees with respect to one portion of the benefits derived from the contract" (A-8 to A-9) and that, "at least to the extent it provides for benefits guaranteed by Hancock, GAC 50 is a guaranteed benefit policy" (A-8). Harris Trust contends, however, that the "crucial question" governing the applicability of the exception "is whether the availability of funds for benefits is dependent upon Hancock's success or failure as an investor." Cross-Petition at 14. That contention, of course, is totally divorced from the language of the exception, which states that a "guaranteed benefit policy" is "an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. § 1101(b)(2)(B).[17]

The proposition urged by Harris Trust in its Cross-Petition, if adopted by this Court, would eviscerate the "guaranteed benefit policy" exception.[18] Virtually all General Account group

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[17] Harris Trust also argues that Hancock is a fiduciary with respect to all the funds held under GAC 50 since "Hancock has chosen to commingle assets backing its guarantees with those representing free funds." Cross-Petition at 15. That argument lacks any factual basis: Hancock has not "chosen to commingle" any assets. Quite the contrary, as is clear in the record, GAC 50 expressly requires that the premiums received by Hancock be placed in Hancock's General Account (A-4).

[18] Harris Trust also urges that GAC 50 does not come within the "guaranteed benefit policy" exception, because, in its view, GAC 50 is not an "insurance policy or contract" within the meaning of 29 U.S.C. § 1101(b)(2)(B), under tests that Harris Trust would import from cases construing the federal securities laws. Cross-Petition at 20. That issue was put to rest by the district court on the basis of the undisputed facts discussed at length in *Harris I* (A-53 to A-56), and the Second Circuit did not disturb those findings. Moreover, the tests urged by Harris Trust have no application to an analysis of the "guaranteed benefit policy" exception. In effect, Harris Trust

(Footnote continued)

annuity contracts provide for some form of participation in the General Account's investment experience, through, for example, the payment of a dividend. Every such participating contract will at times have associated with it what Harris Trust calls "free funds." Under the construction urged by Harris Trust, no such participating contract would ever qualify under ERISA as a "guaranteed benefit policy," even to the extent of guaranteed benefits. There is no support for such a result under the statute, its legislative or administrative history,[19] or any judicial precedent.

Harris Trust's contention that Hancock should be subject to ERISA fiduciary duties with respect to all the assets held under GAC 50 – despite the fact that the contract has at all times provided substantial guaranteed benefits to plan participants – is contrary to the language of the statute and without any judicial support. The Cross-Petition fails, therefore, to present any colorable basis for review.

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would have this Court engraft onto ERISA a prerequisite test for what constitutes "insurance" that is not required by the terms of § 1101(b)(2)(B).

[19] Harris Trust purports to rely upon two DOL advisory opinions, Advisory Opinions 78-8A (Mar. 13, 1978) and 83-51A (Sept. 21, 1983), to suggest that the DOL would consider the extent to which "investments" are guaranteed in determining whether a General Account contract is a guaranteed benefit policy. Cross-Petition at 19-20. As Hancock's Petition in Docket No. 92-1074 points out, however, these opinions address separate account, not General Account, contracts. Petition at 15. Moreover, as the district court noted in *Harris I*, they are merely advisory opinions that, under ERISA, may be relied upon only by the party submitting the request for an opinion and only to the extent the actual situation conforms to that described in the request (A-60).

Conclusion

For all the foregoing reasons, the Court should deny Harris Trust's Cross-Petition for a Writ of Certiorari.

February 22, 1993

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No. 92-1259

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HARRIS TRUST AND SAVINGS BANK, As Trustee of the Sperry Master Retirement Trust No. 2,

Cross-Petitioner,

vs.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF IN SUPPORT OF THE CROSS-PETITION FOR A WRIT OF CERTIORARI

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REPLY BRIEF IN SUPPORT OF THE CROSS-PETITION FOR A WRIT OF CERTIORARI

Cross-Petitioner Harris Trust and Savings Bank ("Harris Trust") submits this Reply Brief in response to the Brief in Opposition to Cross-Petition for a Writ of Certiorari filed by petitioner John Hancock Mutual Life Insurance Company ("Hancock").

Hancock attempts to minimize the significant conflict between the Second and Seventh Circuits with respect to the issues as to which Harris Trust seeks review.[1] As demonstrated in Harris Trust's Cross-Petition, the Second Circuit's interpretation of the scope of ERISA's fiduciary provisions conflicts with the Seventh Circuit in two respects:

(a) The Seventh Circuit has read ERISA's fiduciary provisions to reach conduct in all relevant respects identical to Hancock's in connection with its administration of GAC 50. The Second Circuit, on the other hand, declined to find that Hancock was a fiduciary in connection with its admitted exercise of unfettered discretionary control of the pension contract in issue.

(b) The Seventh Circuit has construed ERISA's fiduciary provisions as governing all aspects of an insurance company's conduct in connection with the investment of pension monies during the "accumulation" phase of an annuity contract. The Second Circuit, on the other hand, declined to do so.

Because the issues raised by Harris Trust in its Cross-Petition are serious points of conflict between the circuits, these issues clearly merit review.

Since the decision below concluded that ERISA reaches *only* free funds – those which Hancock admits are not associated with guaranteed benefits – the vast bulk of pension funds held

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[1] Hancock characterizes the issues presented in Harris Trust's Cross-Petition as "extraordinary propositions" and argues that the portion of the Second Circuit's Opinion as to which Harris Trust seeks review is "not inconsistent with any interpretation of ERISA published by the Department of Labor." Brief in Opposition at pp. 2-3. This is misleading in view of DOL Advisory opinions supportive of Harris Trust's position. Cross-Petition at pp. 19, 20. In any event, these assertions by Hancock are belied by the DOL's own inability to formulate a position on *any* of the issues presented to the court below, despite "an extensive review of the legal and policy issues involved in this matter" and the DOL's recognition that the case "was important and complex." Appendix to Hancock's Petition for a Writ of Certiorari, Docket No. 92-1072 (Dec. 22, 1992) (hereinafter "A-____").

in insurance company general accounts, estimated to be in excess of one-half trillion dollars,[2] would remain free of ERISA protection. Indeed, the *amicus* brief submitted by the New York State Superintendent of Insurance highlights the necessity of affording ERISA protection to pension plan general account contracts. In essence, the Superintendent has admitted that insurers routinely rely upon pension fund deposits to buttress other lines of business, and that state regulators approve of this practice. Moreover, these pension funds would become available to general creditors in the event of insurance company insolvencies. This attitude, which apparently is not atypical, highlights the importance of review by this Court of the issues presented in Harris Trust's Cross-Petition in the event Hancock's petition is granted:

Finally, in opposing the Cross-Petition, Hancock ignores the fact that the issues as to which Harris Trust seeks review are inextricably intertwined with the questions presented by Hancock in its Petition. Any review of the issues presented in Hancock's Petition will necessarily require this Court to examine the intent of Congress in creating a "guaranteed benefit policy" safe harbor under ERISA for certain types of group annuity contracts. This inquiry will require the Court to examine the overall regulatory scheme devised by Congress in ERISA, including such issues as whether Congress intended to regulate the investment activities of insurance companies with respect to general account pension contracts and the breadth of the Guaranteed Benefit Policy exemption. These issues will require an understanding of the issues presented in Harris Trust's Cross-Petition.

Accordingly, and for the reasons stated by Harris Trust below and in its Cross-Petition, if Hancock's Petition is granted, this Court should also review the questions presented by Harris Trust in its Cross-Petition.

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[2] Brief of *Amicus Curiae* American Council of Life Insurance in Support of Petition at p. 1.

I.

THE SECOND CIRCUIT'S DECISION THAT HANCOCK IS NOT A FIDUCIARY AS TO THE CONTRACT ITSELF IS IN CONFLICT WITH OTHER CIRCUITS AND IGNORED HANCOCK'S EXERCISE OF UNFETTERED DISCRETION WITH RESPECT TO THE ADMINISTRATION OF GAC 50

A. *The Second Circuit and the Seventh Circuit Are In Conflict on This Issue*

Hancock seeks to recast and narrow the scope of salient decisions of the Seventh Circuit, in an attempt to justify its claim that the court below did no more than "distinguish" such decisions as *Ed Miniat v. Globe Life Ins. Group, Inc.*, 805 F.2d 732 (7th Cir. 1986), *cert. den.*, 482 U.S. 915 (1987) and *Chicago Board Options Exchange, Inc. v. Connecticut General Life Ins. Co.*, 713 F.2d 254 (7th Cir. 1983) ("CBOE"). The Seventh Circuit correctly concluded in these and other decisions that there may be more than one fiduciary with respect to the contract itself, and that the exercise of discretion in pursuing its rights under a contract may subject an insurance company to ERISA's fiduciary requirements.

The Second Circuit, however, did more than distinguish these cases in concluding that "[o]nly Harris Trust as contractholder has discretionary authority over the guaranteed benefit *qua* policy" (A-13) and that Hancock "does not 'exercise[] any discretionary authority or discretionary control . . . respecting management or disposition of the policy itself." *Id.* In fact, this constricted reading of ERISA directly conflicts with the construction of the statute adopted by the Seventh Circuit.

First, the Second Circuit's conclusion that *only* Harris Trust, as contractholder, can be a fiduciary with respect to the policy itself, conflicts with *CBOE* and *Ed Miniat*. In both of those cases, the Seventh Circuit clearly held that there may be *more than one* fiduciary with respect to the contract

itself,[3] and that an insurance company's exercise of discretionary authority, even in circumstances where the contract is negotiated at arms length, rendered the insurance company an ERISA fiduciary.

Hancock's attempt to obscure this conflict is nowhere more evident than in its treatment of *Ed Miniat*. In its brief in opposition (at p. 6), Hancock relies upon a quotation from the *Ed Miniat* opinion to support its claim that an insurance company's mere reliance upon its contractual rights will not render it subject to ERISA's fiduciary provisions.[4] Hancock, however, tellingly omits the final sentence of the passage, in which the Seventh Circuit stated:

> When a contract, however, grants an insurer discretionary authority, even though the contract itself is the product of an arm's length bargain, the insurer may be a fiduciary.

805 F.2d at 737.[5] Finally, both Hancock and the court below also ignored a prior Second Circuit decision, *F.H. Krear & Co. v. Nineteen Named Trustees*, 810 F.2d 1250, 1259 (2d Cir. 1987).

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[3] Like the district court, the Second Circuit apparently fell into the trap of concluding that, because ERISA explicitly makes the person who holds a group annuity contract a fiduciary, that person is the *only* fiduciary. *Compare* A-13, A-61. This conclusion runs counter to the language of ERISA and countless cases, such as *Ed Miniat* and *CBOE*, in which *multiple* fiduciaries were charged with compliance with ERISA in their dealings with plan assets. *See also* 29 U.S.C. §1105.

[4] The facts of *Ed Miniat* belie this argument. The Seventh Circuit held that the insurer was a fiduciary because of its exercise of unilateral discretion, *granted in the contract*, to reduce the rate of return and increase premiums. *Ed Miniat*, 805 F.2d at 734, 737-38.

[5] Remarkably, Hancock seeks to buttress its already strained argument on this point by citing a recent Eleventh Circuit decision, *Useden v. Acker*, 947 F.2d 1563 (11th Cir. 1991), petition for cert. filed sub. nom., 60 U.S.L.W. 3843 (U.S. June 1, 1992) (No. 91-1944). *Useden*, however, is inapposite. It does not involve an insurance policy or a group annuity contract, which by *statute* are "plan assets." 29 U.S.C. §1101(b)(2). Instead, *Useden* decided whether a commercial lender assumes fiduciary status with respect to a pension plan borrower upon foreclosure, and as such has no relevance here.

There, the Second Circuit concluded that, *after* an entity contracts with a pension plan, "the agreement may give it such control over factors that determine the actual amount of its compensation that the person thereby becomes an ERISA fiduciary with respect to that compensation." The refusal of the court below to apply *F.H. Krear* to Hancock's conduct further illustrates the fundamental conflict between the Seventh and Second circuits on this point.

B. *The Court Below Ignored Uncontradicted Evidence of Hancock's Exercise of Discretionary Authority*

The court below, in attempting to distinguish *Ed Miniat* and *CBOE*, ignored its own finding that Hancock retained absolute discretion to terminate non-guaranteed benefit payments *for any reason* upon 31 days' written notice, and that Hancock's decision to do so did not breach the contract. A- 17-18. In addition, the district court concluded that Hancock had unfettered power at any time to terminate another arrangement under which the Plan had the right to withdraw excess "free funds" and therefore, Hancock's exercise of such discretion breached neither the contract nor any ERISA duties. A- 68-71. Finally, in dismissing the Trustee's common law claims concerning Hancock's breach of the contract's covenant of good faith and fair dealing, the district court again concluded that Hancock possessed and exercised virtually unfettered discretion with respect to investment and income allocation decisions and the like. A- 82-85.

In light of the district court's decision, the attempt by the court below to "distinguish" *Chicago Board* and *Ed Miniat* has created a conflict in the circuits on this issue. Standing alone, the exercise of unfettered discretion to permit or deny withdrawals of excess, *non-guaranteed* funds from its general account effectively gave Hancock the power to fundamentally alter the value of GAC 50 and clearly rendered Hancock a fiduciary with respect to the Contract. *Chicago Board* illustrates this point. There, the Seventh Circuit concluded that the insurer was an ERISA fiduciary to the extent it retained power to amend the contract, *thereby reducing or altering its value*:

> Nevertheless, the policy itself is a Plan asset, and Connecticut General's ability to amend it, and thereby alter its value, is not qualitatively different from the ability to choose investments. *By locking CBOE into the Guaranteed Accounts for the next 10 years Connecticut General has effectively determined what type of investment the Plan must make.* In exercising this control over an asset of the Plan, Connecticut General must act in accordance with its fiduciary obligations.

Chicago Board 713 F.2d at 260 (emphasis added).

Moreover, Hancock's decision to retain free funds by terminating the "rollover" arrangement and the payment of non-guaranteed benefits substantially increased its compensation, by raising its risk charges and expense recoveries and improving its "cash flow." Indeed, the very witnesses upon whom the district court relied in concluding that Hancock' possessed the contractual right to terminate the withdrawal of excess funds testified that Hancock's right to do so was designed to protect its own "cash flow." *See* J.A. 1334, 1762.[6] The ability to protect its cash flow and to enhance its fees and charges is effectively a determination of the amount of its compensation and renders Hancock a fiduciary. *F.H. Krear, supra.*

Hancock's exercise of unfettered discretion with respect to withdrawals and compensation clearly resulted, as in *Chicago Board*, in an alteration of the value of GAC 50 by locking substantial free funds into Hancock's general account. Thus, Hancock "must act in accordance with its fiduciary obligations." *Chicago Board*, 713 F.2d at 260.[7] Accordingly, the court below erred in concluding that Hancock was not a fiduciary with respect to the contract and its analysis of the scope of ERISA in this regard has created a clear conflict between the circuits.

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[6] "J.A.____" refers to the pages of the parties' Joint Appendix submitted in connection with the appeal to the Second Circuit.

[7] Any decision that allows insurance companies, under the guise of merely complying with provisions in contracts granting them, as here, unfettered discretion, to avoid compliance with ERISA creates a huge void in the Congressional intent to protect pension funds.

II.

THE COURT BELOW IS IN CONFLICT WITH A SEVENTH CIRCUIT DECISION THAT CORRECTLY CONSTRUED ERISA AS PROTECTING ASSETS SUCH AS THE FUNDS INVESTED UNDER GAC 50 WHICH ARE SUBJECT TO INVESTMENT FLUCTUATION

The court below concluded that *only* the "free funds" in the plan's Pension Administration Fund ("PA Fund") are governed by ERISA's fiduciary responsibility provisions. By so doing, the court below ignored the sound reasoning underlying the Seventh Circuit's decision in *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Insurance Co.*, 698 F.2d 320, 327 (7th Cir. 1983), which held that, while a general account fund holding pension monies is in a "variable accumulation phase," it does not qualify for the "guaranteed benefit policy exemption." *See Peoria*, 698 F.2d at 327.

It is uncontroverted that the amount in GAC 50's PA Fund available to fund new benefits and for other plan purposes is dependent upon the investment experience of the Hancock general account and allocation of that experience to the PA Fund. J.A. 526, 530. The monies allegedly supporting benefits "guaranteed" by Hancock and the "free money" which may be used to provide future guaranteed or non-guaranteed benefits are all held in the PA Fund. Hancock does not separate those funds which are associated with guaranteed benefits. The *entire* PA Fund receives the benefits and detriments of Hancock's investment performance. J.A. 1641-1674. Accordingly, *all* funds held in the PA Fund and the contract's "Contingency Account" are "attributable" to the "variable part" of GAC 50. S. Rep. No. 93-127, 93rd Cong., 2d Sess. (1974), *reprinted in* 3 Code Cong. & Admin. News 5038, 5077.

The funds supporting the benefits "guaranteed" by Hancock and the "free funds" in excess of the minimum level are commingled and invested together by Hancock. The *entire* fund earns income and generates additional "free funds" to be used

for new benefits and for other plan purposes. Thus, the court below is in direct conflict with the Seventh Circuit in holding that the monies invested by Hancock in its general account, which generated funds admittedly not associated with "guaranteed benefits," are beyond the reach of ERISA.

Because Hancock has elected not to segregate the "guaranteed" from the variable, non-guaranteed portion of GAC 50's funds, the entire PA Fund should fall within the broad remedial requirements of ERISA's fiduciary responsibility provisions. *See, e.g., Smith v. CMTA-IAM Pension Trust*, 746 F.2d 587 (9th Cir. 1984). Accordingly, as in *Peoria*, the entire PA Fund should be considered to be in the "variable accumulation phase," thereby subjecting Hancock to ERISA's fiduciary duty provisions. The Second Circuit's failure to grasp this point thus created a clear conflict as to the two circuits' analyses of this key statutory provision.[8]

III.

THE ISSUES RAISED IN HARRIS TRUST'S CROSS-PETITION ARE INTERTWINED WITH THE ISSUES AS TO WHICH HANCOCK SEEKS REVIEW

As illustrated above, the issues raised in Hancock's petition and Harris Trust's cross-petition are inextricably intertwined. In order to determine whether the Second Circuit erred in imposing fiduciary duties upon Hancock in connection with Hancock's handling of GAC 50's "free funds," this Court must necessarily examine and articulate the scope of the "guaranteed

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[8] In its Brief in Opposition (at 14, n. 19) Hancock seeks to avoid the impact of relevant Department of Labor Advisory Opinions which support the approach to this issue adopted by *Peoria* and rejected by the Second Circuit, arguing they are "merely advisory opinions." Hancock's willingness to pick and choose the DOL opinions this Court should consider, however, is unseemly in light of Hancock's own heavy reliance upon a misreading of DOL Interpretive Bulletin IB 75-2, which pre-dates the DOL opinions on which the Second Circuit relied. Moreover, while Hancock correctly notes that the district court below refused to give credence to these Advisory Opinions, they were *relied upon* by the circuit court.

benefit policy" exemption. In so doing, this Court must determine the extent to which Congress intended to regulate insurance industry practices concerning the investment of pension funds in general accounts. This examination will result in determinations which bear directly upon the issues presented in the Cross-Petition. Thus, granting the cross-petition will allow this Court to delineate the contours of federal law in this important area in a comprehensive fashion, thereby eliminating the conflicts described above and resolving the uncertainties in this area cited by Hancock and *amici*. For this additional reason, Harris Trust's cross-petition should be granted.

Conclusion

The Cross-Petition for a writ of Certiorari should be granted in the event the Petition is granted.

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Respectfully submitted,

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